

**Somasundaram P. Ltd. Vs. Commissioner of Income-tax**

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**Court :** Karnataka

**Decided On :** Jan-04-1985

**Reported in :** ILR1985KAR3412; [1985]152ITR664(KAR); [1985]152ITR664(Karn)

**Judge :** Mohammad Sharif and ;S.A. Hakeem, JJ.

**Acts :** [Income Tax Act, 1961](#) - Sections 104, 104(1), 256(2), 263, 264 and 271(4A)

**Appeal No. :** Income-tax Referred Case Nos. 230 and 231 of 1978

**Appellant :** Somasundaram P. Ltd.

**Respondent :** Commissioner of Income-tax

**Advocate for Def. :** K. Srinivasan, Adv.

**Advocate for Pet/Ap. :** Swaminathan, Adv.

**Judgement :**

Jagannatha Shetty, J.

1. These are references under s. 256(2) of the I.T. Act, 1961 ('the Act'). The questions referred by the Income-tax Appellate Tribunal are :

'(1) Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in law in holding that the provisions of section 104 are attracted for the assessment year 1965-66

(2) Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in law in holding that the provisions of section 104 are attracted for the assessment year 1966-67 ?'

2. The assessee is a private limited company. It is a company to which the provisions of s. 104 of the Act are applicable. The assessment years involved are 1965-66 and 1966-67, the relevant previous years being the years ending on April 18, 1965 and April 18, 1966, respectively. It appears, the assessee had earned large income on the sale of import entitlements which had not been accounted for in the books of account. In regard to this income, assessee entered into a settlement with the Commissioner under s. 271(4A) of the Act admitting the income as under :

Rs.1962-63 2,15,243 1963-64 2,74,387 1964-65 2,11,600----- 7,01,230-----

3. Subsequently, the Commissioner of Income-tax passed orders under s. 264 or s. 263, as the case may be, determining the income for the assessment years 1962-63 to 1964-65 according to the terms of the settlement. These orders were passed on March 4, 1969.

4. The income agreed to be taxed under the settlement became the basis for taking proceedings by the ITO under s. 104(1) of the Act. For the assessment year 1965-66, the ITO made an order under s. 104 determining

the balance available for the distribution as dividend at Rs. 15,192. For the assessment year 1966-67, he determined the distributable income at Rs. 22,573. For both these years, he levied additional super-tax under s. 104

5. In the appeals preferred by the assessee against the said levy, it was urged before the AAC that for the assessment year 1956-66, the assessee company should have distributed dividends by April 18, 1966, but it could not declare any dividend since by that time the company had been saddled with the tax liability of Rs. 3,26,841 as a result of the assessment made by the ITO, although that sum was reduced on March 17, 1969, to Rs. 1,28,944. It was also urged before the AAC that there was an anticipated loss of Rs. 1,12,826 which was subsequently written off as bad debt. It was thus claimed that the directors of the company had acted reasonably in not declaring any dividend. But the AAC did not accept these contentions. Relying upon the decision of the Supreme Court in *Gobald Motor Services (P.) Ltd. v. CIT* : [1966]60ITR417(SC) , the AAC held that the action taken by the ITO was justified. He observed :

'...I would have been prepared to accept the appellant's contention that it had come forward for a settlement only to have its tax liabilities settled if such concealed income had not been credited in its books of account. However, this is not the case here. As much as Rs. 3,56,000 (or more) appears to have been credited in the books during the assessment year 1966-67. The Income-tax Officer has merely proceeded from the income admitted by the appellant for various year...'

6. The assessee next came in appeal before the Tribunal. The Tribunal also rejected the appeals in view of the assessee's own proposal for settlement and its subsequent act by which the income from undisclosed sources was brought into the books of account.

7. Before the Tribunal, it was urged that the settlement with the Department was reached only to buy peace and that does not mean that the assessee had income outside the books. But the Tribunal observed that on the facts, such an argument was untenable since the assessee subsequently brought into the books the income admitted in the settlement before the Commissioner. The Tribunal also observed that the assessee had earned profits on sale of import entitlements and invested the same in fictitious names without accounting in the books of accounts.

8. It is thus seen that all the authorities have proceeded on the basis that the assessee had kept outside the books quite a large amount of profits earned by the sale of import entitlement and brought it into the books after the settlement reached with the Commissioner under s. 271(4A) of the Act and such amounts could properly be taken into consideration for determining the available surplus.

9. Having regard to the findings recorded by the Tribunal, it seems to us that it is not necessary to consider all the contentions urged by Sir Swanminathan, learned counsel for the assessee. It is sufficient if we consider the income of Rs. 7,01,230 admitted before the Commissioner under the settlement for the assessment year 1962-63 to 1964-65. If this income is taken into consideration for the purpose of determining the surplus for distribution as dividend, then there is no doubt and indeed it was not disputed that the order of the Tribunal is justified.

10. But Mr. Swaminathan, learned counsel for the assessee, submitted that the income disclosed under the settlement should not taken into consideration since the assessee invoked the provisions of s. 271(4A) of the Act only to buy peace and the amount agreed upon for the purpose of additional tax in the settlement should not be considered as real income.

11. Before considering this contention, we may briefly summaries the purpose of and the power conferred by s. 104 of the Act. The object of this section was to prevent avoidance of tax by the shareholders of a company in which the public are not substantially interested. The ITO has been given the power under this section to levy additional tax on the (statutory percentage of) undistributed income of a company. The ITO should not, however, make an order under the section if he is satisfied, that having regard to the losses incurred by the

company in the earlier years, or to smallness of the profit made in the accounting year, the payment of a dividend or a larger dividend than that declared would be unreasonable. For determining whether the dividend distributed is less than the statutory percentage of the distributable income on which the additional tax is payable, any distribution made after 12 months immediately following is the expiry of the previous year should be disregarded.

12. The effect and the implication of s. 104 (corresponding to s. 23A of the 1922 Act) of the Act have been clearly laid down by the Supreme Court in CIT v. Gangadhar Banerjee : [1965]57ITR176(SC) and CIT v. Asiatic Textiles Ltd. : [1971]82ITR816(SC) . There, it was observed that the ITO, acting under s. 104, is not assessing any income to tax and that will be assessed in the hands of the shareholder. The ITO is required to do only that which the directors should have done. The yardstick to be applied by the ITO should, therefore, be that of a prudent businessman. The reasonableness or the unreasonableness of the amount distributed as dividends should be judged by business considerations depending upon the facts of each case. In considering whether there was any available distributable profit, the ITO must, therefore act as a prudent businessman and take into consideration all losses, liabilities, etc. In so considering, he must apply an 'arm-chair-principle' to find out whether the act of the company was unreasonable from the commercial point of view.

13. In Gold Motor Service (P.) Ltd.'s case : [1966]60ITR417(SC) , the Supreme Court has observed that the deliberately concealed income which came to the included in the assessable income of the assessee for income-tax purposes is liable to be included in the commercial profits of the assessee.

14. This principle is no less important in the present case. Here is a case where the assessee had deliberately omitted in the books of accounts, the profits earned on the sale of import entitlements. It cannot, therefore, be legitimately urged that income should not be considered for the purpose of arriving at the real commercial profits. Not merely that, the assessee itself had subsequently brought that income into the books as found by the Tribunal. The decisions directly in point on the issue is the decision of the Supreme Court in Gobald Motor Service (P.) Ltd.'s case : [1966]60ITR417(SC) .

15. Mr. Swaminathan for the assessee, however, raised a new point. He, inter alia, contended that the dividend for the year 1965-66 ought to be declared by April 18, 1966, and the dividend for the year 1966-67 ought to be declared by April 18, 1967. For the year 1962-63, the income assessed taking into consideration the declared income was Rs. 6,50,431 and the tax liability thereon was Rs. 3,26,841. There was not penalty imposed till April 18, 1966, or April 18, 1967. Although there was no order passed levying penalty or levying sales tax, the possibility of such a levy consequent on the voluntary disclosure of income for the years 1962-63 to 1964-65, was perhaps very much in the minds of the directors and they were, therefore, justified in not declaring any dividend. So ran the contention.

16. But it must be noted that this point has not been specifically raised before any one of the authorities. It is, in our opinion, now too late to raise this contention. Similar new contention was not allowed to be raised before the Supreme Court in Gobald Motor Service (P.) Ltd. v. CIT : [1966]60ITR417(SC) . There it was observed (p. 422) :

'He urged that it was quite apparent from the order of the Income-tax Officer that none of the considerations pointed out by this court had been considered. We agree with him that the Income-tax Officer did not consider the question like a prudent businessman. But, as we have already said, the assessee did not raise this point either before the Appellate Assistant Commissioner or the Appellate Tribunal. If this point had been raised, the facts relating to the considerations mentioned in the observation of Subba Rao J. would have been brought on the record. We feel that it is now too late to permit him to raise this point...'

17. Having regard to the findings recorded by the Tribunal and the circumstances revealed in the case, we do not think that the Tribunal has taken any erroneous view of the law.

18. In the result, we answer the questions in the affirmative and against the assessee.

19. In the circumstances of the case, we make no order as to costs.